PITCHER PARTNERS
ACCOUNTANTS • AUDITORS • ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Level 1
80 Monash Drive
Dandenong South
Victoria 3175

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

Tel: +61 3 8610 5000
Fax: +61 3 8610 5999
partners@pitcher.com.au
www.pitcher.com.au

J BRAZZALE
M W PRINGLE
D A THOMSON
M J LANGHAMMER
S SCHONBERG
S DAHN
A R YEO
P W TONER
D R VASUDEVAN
B J BRITTEN
K L BYRNE
S D WHITCHURCH
D J HONEY
G J NIELSEN
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M G JOZWIK
B POWERS
K J DAVIDSON
J C CHENG

16 June 2017

Mr Henry Carr
Director
Fair Entitlements Guarantee Recovery Team
Workplace Relations Programmes Group
The Department of Employment
12 Mort Street
CANBERRA ACT 2601

By email: ImprovingFEG@employment.gov.au

Dear Sir

Pitcher Partners Response to the Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee Scheme Consultation Paper

We appreciate the opportunity to respond to the consultation paper – reforms to address corporate misuse of the Fair Entitlements Guarantee scheme.

Our response is limited to those sections of the consultation paper in which we consider we are able to make substantive comment.

Pitcher Partners is a national association of independent firms. The association is represented by Pitcher Partners Melbourne, Pitcher Partners Sydney, Pitcher Partners Perth, Pitcher Partners Adelaide, Pitcher Partners Brisbane and Pitcher Partners Newcastle. Pitcher Partners has Insolvency practices in our Sydney, Melbourne, Perth and Adelaide offices.

Sharp Corporate Practices and Threats to FEG Recoveries

We make the following general comments in relation to the preliminary sections of the Consultation Paper:

- We are identifying increasing evidence of those activities identified as sharp corporate practices in both insolvency administrations including significant employee entitlements and those that do not; and
- As an overarching principal, we consider that the reduction of sharp corporate practices, improvements to FEG recoveries and more effective liquidation outcomes generally requires:
  - aggressive efforts to ultimately remove from the profession registered liquidators who facilitate such arrangements or fail to adequately investigate such arrangements;
  - in the interim, active efforts from creditors (including FEG) to remove and replace liquidators known or suspected of engaging in supporting such activity;

Ref: GMR| LDP| KB| C.3174660.1

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– increased ASIC activity in prosecuting directors, officers and advisors suspected of engaging in or facilitating such activity; and
– legislative change to prohibit unethical but legal activity and to redraft recovery provisions to provide greater certainty as to the relevant tests.

Reform to Part 5.8A of the Corporations Act

Question 1

Pitcher Partners supports the proposal to reform and clarify Part 5.8A of the Corporations Act (Cth) 2001 ("the Act"). Liquidators within Pitcher Partners are currently undertaking recovery action pursuant to Part 5.8A of the Act and from our experience, we also share the concerns raised in the Consultation Paper as to the operations of the provisions.

Question 2

In relation to the specific options proposed by FEG, we consider:

- Option 1: we support the extension of the fault element to include a person recklessly entering into an agreement preventing the recovery of some or all of a company's employee entitlement liabilities. Such a test would encourage liquidators and employees to more readily undertake civil recovery action and ultimately dissuade directors and other officers from engaging in such courses of action. Currently, the difficulties encountered by liquidators in pursuing such actions, and the limited likelihood of ASIC undertaking proceedings, have the effect that the existing legislation does not act as a sufficient deterrent to prevent or reduce the incidence of such activity;
- We make no comment as to the proposal to increase the current penalty save to acknowledge that additional prosecution of identified suspected breaches will act as a greater deterrent than an increase in the maximum penalty; and
- Option 2: we support FEG's proposal (and support this option preferentially to option 1) to introduce a separate civil penalty provision with an objective test. Further, we consider a test based on objective assessment of the agreement or transaction (option 2B), roughly aligned with the consideration of factors in Section 588FDA would further enhance the powers of ASIC and liquidators, and act as a greater deterrent to directors and officers.

Question 3

We agree, particularly, that the requirement pursuant to Section 596AB of establishing a person's actual, subjective intention to avoid some or all of the employee entitlements is a significant impediment to the effective use of the provisions. We note and agree with FEG's concerns to the drafting of the various provisions and the lack of clarity as to the circumstances in which the Part is anticipated to operate, however consider these concerns to be of far less significance than the requirement to prove an actual subjective intention.

Question 4

The proposed amendments do not assist recovery efforts in circumstances where the benefits flow to persons other than directors of the company and where the directors do not have the capacity to meet any adverse judgment.

We are of the view that amendments to Part 5.8A of the Act provisions should be included which enable action to be undertaken against any party which has benefitted as a result of an impugned transaction. Specifically, this may include recipients of assets of the insolvent entity (including in circumstances where the receiving entity paid market value for assets but was aware or reasonably suspected the purpose of the transaction was to defeat employee entitlements) and non-director guarantors of secured debt where a secured creditor is the beneficiary of the transaction at the expense of employees.

Questions 5-7

We are supportive of appropriate legislative reform to reduce the abuse of corporate structures to avoid paying employee entitlements.

We note that the unreasonable director-related transactions provisions within Section 588FDA of the Act already apply to many of the behaviours contemplated within this section of the consultation paper. However, additional measures providing greater clarity and certainty that enhance the existing recovery options are supported.

We have been provided with a copy of ARITA's submission and support its view that "any such contribution or compensation should be payable to the company in liquidation, to be distributed by the liquidator according to the usual winding up provisions of the Corporations Act. We are not supportive of the legislative introduction of new, standalone priority claims beyond those which already exist in established provisions such as ss 433, 556 and 561."

Question 8

We do not consider that legislative change is required, or that the impact of reliance on the FEG scheme should be relevant in director sanctioning. Generally, we support FEG's proposal for tougher sanctions on directors, particularly in respect of sharp business practices, but are firmly of the view that such sanctions could be achieved through stricter enforcement of the existing statutory regime. Additionally, the inclusion of specific FEG/employee-related sanctions may merely redirect sharp corporate practices to unduly impact other creditor groups.

It is clear that significant additional funding is required to facilitate additional action by ASIC, and to fund liquidators under the Assetless Administration Funding program to identify such activity and support ASIC's efforts in this regard.

Question 10 - Trusts

Pitcher Partners support FEG's funding of the appeal of the judgement in Re Amerind Pty Ltd (Receivers and Managers Appointed) (In Liquidation) in relation to the priorities applicable to trust property in insolvency administrations. As a practical matter, the adoption of the decision of the courts in Re Amerind and Independent Contractor Services (Aust) Pty Ltd will cause significant disruption to insolvency practice as engaged in by liquidators and their staff on a day to day basis as insolvency firms would need to adjust their training practices, precedents and reporting to ASIC at the very minimum. Additionally, administrators priorities pursuant to Section 443E and both FEG and employees priorities pursuant to 556(e), (g) and (h) are compromised by this interpretation.

Accordingly, in the event that the Re Amerind appeal is unsuccessful, we support legislative change to ensure that the section 556 priorities apply to trust property.

We see no reasonable basis on which this change should not be implemented.

Question 10 – Interaction of s556 and s561

We respectfully submit that it is not clear within the provisions of the Act that it is a considered policy objective that certain employee entitlements be paid ahead of the general costs of the receiver or liquidator where there is a secured creditor which will not be repaid in full out of assets subject to a non-circulating security interest. We note that the only provision in the Act which deliberatively deals with the respective priorities of the general costs of a liquidator viz a viz employee entitlements is Section 556 of the Act which elevates the liquidator's costs above the priority of employee entitlements.

We acknowledge FEG's view as to the priority of liquidator's 'general costs, however note that there are competing views on the proper construction as to whether the provision provides a priority for general liquidation expenses. We understand there is no clear Australian authority on this point.

To the extent that FEG's position is adopted, either by the courts or by legislative change, this may further erode competition in the insolvency industry and reduce the number of practitioners in the industry by significantly reducing their remuneration, in circumstances where:

- external administrators already carry out a significant amount of unfunded work particularly in court appointed and creditors voluntary liquidations. In this regard, research in 2012 identified that nationally, insolvency practitioners are required to personally fund disbursements of $1.4m and remuneration of $47m solely in the conduct of their roles as liquidators in court appointed liquidations; and
- the proposed change will increase the occasions on which external administrators are required to undertake significant unfunded investigations and meet statutory reporting requirements, in a climate of increased sharp corporate practices. In such circumstances, liquidators may either undertake only the minimum investigations required by law (thereby eroding the impact of existing legislation and proposed legislative change in the consultation paper) or, alternatively, risk the incurrence of substantial write offs in the absence of recoveries not subject to security interests.

Question 11

It is our view that Section 433 of the Act should be amended to align with the priorities afforded employees under Section 561 of the Act irrespective of whether the company is in liquidation at the time of the appointment of a receiver.

Currently, the law under Section 433 imposes an obligation on receivers and managers to prioritise the payment of employee entitlements for:

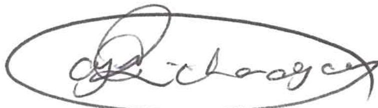
- Wages and superannuation payable in respect of services rendered by employees before the date of the appointment of receivers and managers;
- Amounts owed by the company to employees by way of leave which have become due and payable on or before the date of the appointment of receivers and managers; and
- Retrenchment payments payable to employees of the company where the amount becomes payable before, on or after the appointment of receivers and managers.

As a result, annual and long service leave which had merely accrued in favour of an employee but which was not due and payable does not attract a priority pursuant to Section 433 of the Act (unless a liquidator is also appointed in which case Section 561 of the Act also applies).

We recommend legislative change to remedy this inconsistency.

Should you have any queries in relation to this submission, please do not hesitate to contact me or Olivia Richardson of this office on (03) 8612 9305.

Yours faithfully



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National Chairman